BOENNING & SCATTERGOOD
ESTABLISHED 1914

Equity Research

Aqua America, Inc.

(WTR-NYSE)

June 12, 2019

Water | Environment

Rating/Risk:	Outperform/Low
Price:	$40.58
Target Price:	$43.00

Aqua/Peoples regulatory process enters litigation in PA, but last-minute (non-unanimous) settlement reached; We expect PUC approval despite I&E objection.

Summary: Yesterday, we were in Harrisburg to attend evidentiary hearings for the Aqua/Peoples deal, which entered formal litigation in PA this week due to disagreement among key parties to the case regarding how to deal with certain high-risk gas gathering systems. While the unexpected delay in the regulatory approval process is by no means a positive, yesterday's hearing began with the news that terms of a non-unanimous settlement have been agreed to, with the formal settlement agreement to be filed with the PUC by June 26. We expect the PA PUC to approve the Peoples acquisition, and maintain our Outperform rating for WTR, with our $43 target price based on our proprietary regulation-weighted valuation model (click HERE for rankings and model).

Key Points:

- **PA regulatory approval dragging out, but settlement reached.** The Pennsylvania regulatory approval process for Aqua/Peoples is taking longer than initially expected, with actual litigation beginning with yesterday's hearings in Harrisburg. There appears to be light at the end of the tunnel, however, with parties telling the ALJ yesterday that terms have been reached on a non-unanimous settlement. The proposed timeline calls for a formal settlement agreement filing by June 26, with opposing party briefs due July 11 (the next two PUC Public Meetings are July 11 and August 8). The PUC's Bureau of Investigation and Enforcement (I&E) and the PA Office of the Small Business Advocate (OSBA) are opposing the non-unanimous settlement.
- **Handling of Equitable gas gathering assets the sticking point.** The main issue of contention is how to handle certain gas gathering assets acquired by Peoples as part of the 2013 Equitable deal – specifically the "Goodwin and Tombaugh" system. This gathering system serves roughly 1,600 customers, but has very high leakage rates and is a non-regulated asset that has been the subject of ongoing controversy since the Equitable acquisition (it was noted during yesterday's hearing that Aqua factored this issue into its negotiated purchase price). Fixing the G&T system would cost $122 million (or $75,000 per customer), and the non-unanimous settlement (which includes OCA) would allow Aqua/Peoples single-tariff rate recovery on this investment.
- **I&E opposes settlement, prefers abandonment of G&T system.** As it has since the Peoples/ Equitable merger in 2013, I&E continues to strongly oppose allowing the sizable per customer investments to fix G&T into rate base, on the basis that this is not in the public interest and that it would amount to excessive subsidization by existing Peoples customers. Instead, I&E prefers abandoning the G&T system and moving these customers to propane, noting that Peoples CEO Morgan O'Brien has indicated that in some cases abandonment is in the public interest (for his part, O'Brien stressed he said *in some cases*, and this may not be one of those cases). Discussion of rate recovery vs. abandonment of the G&T system dominated yesterday's hearing.
- **PUC approval likely, clearing the way for closing.** We anticipate the PUC approving the non-unanimous settlement despite I&E's opposition. G&T is a problem asset that must be addressed regardless of owner, and the settlement lays out clear plan with a defined timeline (7 years), to be executed by a credible counterparty in Aqua with manageable impact on existing ratepayers (a 1% bill increase). In our view, a PUC rejection of the settlement would represent a de facto endorsement of abandoning the G&T customers, which would be unpopular politically, further tipping the scales toward approval. Of note, I&E lacks the ability to appeal a PUC ruling, so approval by the PUC would likely stand (OSBA can appeal, but rarely does), clearing the way for the Aqua/Peoples deal to close according to the existing "midyear" timetable.

EPS

Current	Q1	Q2	Q3	Q4	FY
2018A	$0.29	$0.37	$0.44	($0.02)	$1.08
2019E*	$0.09	$0.40	$0.50	$0.28	$1.28
Prior	**Q1**	**Q2**	**Q3**	**Q4**	**FY**
2019	$0.09	$0.40	$0.50	$0.28	$1.28
Consensus	**Q1**	**Q2**	**Q3**	**Q4**	**FY**
2018	$0.29	$0.36	$0.43	$0.31	$1.41
2019	$0.30	$0.39	$0.46	$0.32	$1.44
2020	$0.31	$0.42	$0.50	$0.33	$1.56

**1Q represents actual results.*

Revenue	Current	Prior	Consensus
2018A	$838	$838	$847
2019E	$894	$894	$900

Market Data	
Current Price	$40.58
52-Week Range:	$32.09 - $41.51
Market Cap. (M)	$8,755
Shares Out. (M):	215.7
Float Shs. (M):	215.2
Inst. Ownership:	49%
Short Interest (M)	10.4
Avg. Daily Vol. (Shs.Th.):	967.8
ADTV (M):	$39.27
Valuation	
P/E 2019E	31.8x
Capitalization	
Book Value / Share:	$9.37
Net Cash / Shares:	$0.02
Enterprise Value (M):	$11,515.3
Dividend / Share:	$0.88
Dividend Yield:	2.2%

Note: All estimates reflect stand-alone Aqua. We have discontinued stand-alone Aqua estimates for 2020 given our expectation of the Peoples acquisition closing in 2019.

Ryan M. Connors
610.832.5212
rconnors@boenninginc.com

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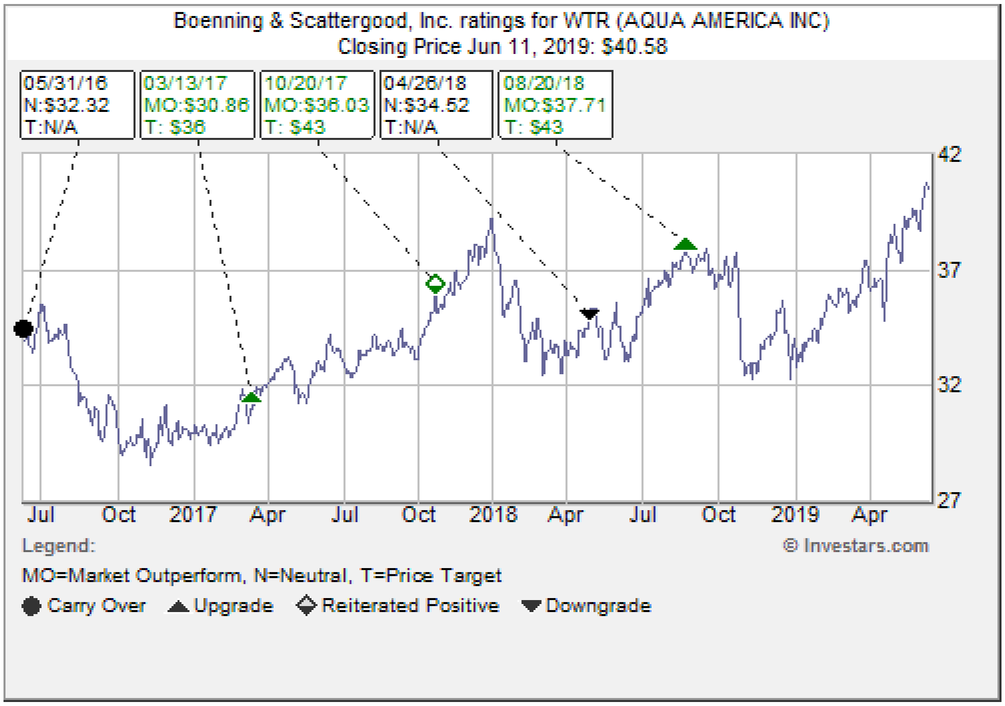
Disclosure Appendix

Rating and Price Target History:



Risk Factors:

The realization of any or all of the following risk factors, among others, may adversely affect the company's stock and prevent it from reaching our target price: regulatory lag; economic regulation; environmental law; water availability; weather; funding; and inputs.

Analyst Certification:

The research analyst whose name appears on this research report certifies that: (1) all of the views expressed in this research report accurately reflect their personal views about the subject security or issuer, and (2) no part of the research analysts' compensation was, is, or will be directly or indirectly related to the specific recommendations or views expressed by the research analysts in this research report.

Important Disclosures:

Analyst compensation is based on, in part, Boenning & Scattergood, Inc.'s profitability, which includes revenues from investment banking. Boenning & Scattergood expects to receive or intends to seek compensation for investment banking services from the subject company in the next three months.

Boenning & Scattergood has managed a public offering and received compensation from the subject company within the past 12 months.

Boenning & Scattergood's Ratings System:

Our three-tier investment ratings are based on a stock's return potential relative to a broad market index:

- ***Outperform (Buy):*** The security's total return over the year or longer is expected to exceed the total return of the S&P 500™ over the identical period.
- ***Neutral (Hold):*** The security's total return over the next year or longer is expected to be roughly equivalent to the total return of the S&P 500™ over the identical period.
- ***Underperform (Sell):*** The security's total return over the next year or longer is expected to be less than the total return of the S&P 500™ over the identical period.

Our four-tier risk ratings are based on a mix of price volatility and fundamental factors relative to the market and peer group:

- ***Low:*** The security has higher-than-average fundamental predictability and/or lower-than-average price volatility.
- ***Moderate:*** The security has average fundamental predictability and/or average price volatility.
- ***High:*** The security has lower-than-average fundamental predictability and/or higher-than-average price volatility.
- ***Speculative:*** The security has very inconsistent fundamental predictability and/or very high relative price volatility.

Ratings Distribution (3/31/19):

Coverage Universe (a)	% of Universe
Outperform (Buy)	43%
Neutral (Hold)	48%
Underperform (Sell)	0%
Not Rated	9%

Investment Banking Clients (b)	% of Rating Group
Outperform (Buy)	13%
Neutral (Hold)	18%
Underperform (Sell)	0%
Not Rated	13%

(a) Total may not add up to 100% due to rounding.
(b) Related to services provided within the past 12 months.